SUPREME COURT, U. S.

No. 127

JAN 22 1968

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IN THE

Supreme Court of the United States

October Term, 1967

READING COMPANY, *Petitioner*

v.

FRANCIS SHUNK BROWN, 3RD, *Trustee of the Estate of* I. J. KNIGHT REALTY CORP., *Bankrupt, Respondent*

and

UNITED STATES OF AMERICA, *Respondent*

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

REPLY BRIEF FOR PETITIONER

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INTRODUCTION

The issue in this case is whether damages arising from the negligence of a receiver operating the business of a debtor under Chapter XI of the Bankruptcy Act are expenses of administration under Section 64a(1) of the Act, payable out of the assets of the estate. Both the Government and the trustee endeavor to becloud this issue by referring to pre-bankruptcy torts and by discussing what other rights claimants have or had if their claims are not expenses of administration. No pre-bankruptcy torts are involved and petitioner submits that the other arguments of the Government and trustee are without substance.

I. THE CLAIMS HERE INVOLVED DO NOT COME WITHIN THE PROVISIONS OF SECTION 63 OF THE BANKRUPTCY ACT.

Both the Government and the trustee treat the fire loss claims as if they were provable under Section 63 of the Bankruptcy Act. The Government asserts that the claims would have been provable under Section 63a(7) of the Act if suit had been brought thereon prior to the bankruptcy (Brief, p. 5). The trustee argues that, if the claims are not provable, they are not discharged under Section 17 of the Bankruptcy Act (11 U.S.C. §35) (Brief, p. 12). Both contentions are based upon the fallacious assumption that the claims are debts of the bankrupt within the meaning of Section 63. The claims here involved are not debts of the bankrupt. They are made against the estate for damages resulting from a tort of the receiver operating the business (R. 21). This distinction is well expressed in 3 *Collier on Bankruptcy*, Section 63.03, p. 1764 as follows:

> "The express language of §63, '*Debts of the bankrupt* may be proved and allowed', clearly limits the class of provable claims to those which can be asserted against the debtor in bankruptcy."

In a footnote to this statement, *Collier* states (pp. 1764-65):

> "This, of course, involves observing the difference between provable debts and those claims arising after bankruptcy which may be termed expenses of administration. (Citing earlier section.) Such claims are not obligations of the debtor in bankruptcy, but are rather claims against the assets of his estate in the hands of the court and its officers. Thus taxes accruing as a consequence of the operation of a bankrupt corporation's business by a bankruptcy receiver are not provable debts owing by the corporation itself but are obligations of the receivership to be classed as administrative expenditures." (Citing *McColgan v. Maier Brewing Co.*, 134 F.2d 385, (9 Cir. 1943) cert. den. 320 U.S. 737, and other authorities.)

Further answer to the Government's contention is to be found in Section 378(2) of the Bankruptcy Act 11 U.S.C. 778(2) (Appendix, p. 9) which provides that when a bankruptcy follows an arrangement, the bankruptcy "proceeding shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition of adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition [for the arrangement] was filed. . . ." In other words, the legal effect is to date the bankruptcy from the date of the original Chapter XI petition, which was prior to the fire (R. 21).

II. The Claims Here Involved Are Just as Much Expenses of Administration as Are Taxes, Interest Thereon and Penalties.

The Government states (Brief, p. 14) that when, as in a Chapter XI proceeding, a receiver, trustee or debtor continues to operate an insolvent business "the category of administrative expenses is enlarged to include at least

some expenses that are 'necessary' in the sense that without the goods or services which they represent the business would be unable to operate." It argues that there is no justification in extending this treatment to petitioner's tort claims. In *Boteler v. Ingels*, 308 U.S. 57, 60 (1939), this Court held that a trustee in bankruptcy is liable for penalties imposed for nonpayment of state vehicle license fees since the "fees and penalties in issue were incurred by the trustee in operating the bankrupt business. . . ." Certainly, if the Government is correct here in its attempted rationalization of expenses of administration as excluding petitioner's tort claims, such reasoning would exclude penalties for nonpayment of state licenses as well.

This Court also held that federal taxes incurred during the period when a business is being operated by a debtor in a Chapter XI arrangement are entitled to first priority as administrative expenses, even though Congress specifically gave taxes a fourth priority under Section 64a(4) of the Bankruptcy Act. *Nicholas v. United States*, 384 U.S. 678 (1966). At 384 U.S. 687-88 the Court stated:

> "Taxes incurred in the pre-arrangement period must be content with a fourth priority under Section 64a(4) of the Bankruptcy Act. On the other hand, *taxes incurred during the arrangement period are expenses of the Chapter XI proceedings and are therefore technically a part of the first priority under Section 64(1).*" (Emphasis supplied.)

In the same case this Court ruled that interest on the foregoing Chapter XI taxes, if it had accrued during the arrangement period, would also have been an expense of administration (384 U.S. 682-90).

In both the *Boteler* and the *Nicholas* cases this Court referred to the provisions of 28 U.S.C. §960, where Congress directed that federal receivers shall be taxed as if they were conducting a private business. 308 U.S. at 60-61; 384 U.S. at 690. The immediately preceding section, 28

U.S.C. §959(a) and (b) (Petitioner's brief, p. 27) provides that federal receivers conducting a business shall do so according to the requirements of the laws of the state in which they are operating, in the same manner as a private owner or possessor. This is a clear mandate of Congress that the trustee is here liable for damages resulting from his torts the same as any other person conducting a business.[1]

The Department of Justice has repeatedly cited *Collier on Bankruptcy* in its brief (see e.g. pp. 10, 11, 14, 15, 22, 25, 31, 32), but omitted citing the section which directly bears on the issue here presented. At 3 *Collier on Bankrupty*, §62.15 (p. 1540) it is stated:

> "Among other expenses incident to conducting a business and therefore allowable as administrative expenditure may be royalties for a "patented process of manufacture, fees of detectives hired to discover persons involved in theft of assets, *payments on claims for personal injuries inflicted in the operation of a business*, rent, insurance, commissions, cost of raw material or merchandise purchased for manufacturing or resale *and any other expense ordinarily attendant upon active participation in commercial or industrial life.*" (Emphasis supplied.)

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[1] The Government in its brief (pp. 5, 17-18) now reverses its position below and concedes that there might be circumstances under which tort claims arising during an arrangement might be entitled to a first priority as "necessary" expenses of administration, such as, it explains, torts arising from an activity which was an integral and essential element of the continuation of the business. Congress did not make any such distinction. In any event, the fire which caused the losses here arose in connection with an activity which was an integral and essential element of the continuation of the business, namely maintenance of the building which was being operated for the benefit of the receiver's tenants (R. 6-12, 21). Furthermore, it is difficult to imagine any situation where, under the prevailing law of agency and torts, a trustee would not be liable for damages arising from any activity involved in carrying out the business because any such activity would be deemed "integral and essential."

III. Respondents' Contentions Are Not Supported by the Cited Amendments to the Bankruptcy Act.

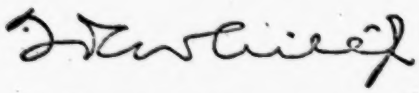
In support of its argument that Congress has shown a purpose to limit the priorities accorded in Section 64, the Government asserts (Brief, p. 10) that Congress has changed those priority provisions on several occasions, and in "each significant instance the result has been to limit, and not to expand, the category of claims accorded priority; . . ." Although petitioner does not consider the point which the Government is endeavoring to make of much help to the Court in determining the meaning of "costs and expenses of administration," it takes issue with the Government's summarization of the legislative changes. Numerous significant changes actually enlarged the priorities. See 3 *Collier on Bankruptcy*, §64.01, pp. 2048-62.

Both the Government (Brief, p. 31) and the trustee (Brief, p. 13), in support of their contention that Congress did not intend to include tort claims as expenses of administration under Section 64a(1), argue that, when Congress intended to include tort claims as expenses of administration in bankruptcy proceedings it knew how to do so, citing Section 77(n) of the Bankruptcy Act 11 U.S.C. §205(n). This argument overlooks the fact that the intent of Section 77(n) was to give a priority status to tort claims which had not theretofore been recognized as expenses of administration in railroad equity receiverships, namely claims for personal injuries to, or death of, *employees* arising *prior* to the receivership. See e.g., *In re: Hudson and Manhattan Railroad Company*, 178 F. Supp. 103 (S.D. N.Y. 1959), aff'd, 273 F. 2d 707 (2d Cir. 1960). *Employee* injury and death claims arising *during* the receivership had always been given priority as expenses of operation of the business. See 5 *Collier on Bankruptcy*, §77.21, fn. 24 and 25, pp. 571-73.

CONCLUSION

The judgment of the court below should be reversed.

Respectfully submitted,



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January 22, 1968

STATE OF PENNSYLVANIA
COUNTY OF PHILADELPHIA ss.

I, THOMAS RAEBURN WHITE, JR., counsel for the petitioner herein, and attorney of record for petitioner in the courts below, state that on the 22nd day of January, 1968, I served five copies of the foregoing Reply Brief for Petitioner on the respondents, as required by Rule 33, by personally mailing said copies hereof to Messrs. Dechert, Price and Rhoads, in care of their office, 1600 Three Penn Center Plaza, Philadelphia, Pennsylvania 19102, to the Solicitor General, Department of Justice, Washington 25, D. C., and to Richard M. Roberts, Assistant Attorney General, Department of Justice, Washington, D. C. 20530, the attorney who argued the case for the United States in the courts below.

THOMAS RAEBURN WHITE, JR.
Member of the Bar of the United States Supreme Court

APPENDIX

"Sec. 378. Upon the entry of an order directing that bankruptcy be proceeded with. . . .

(2) in the case of a petition filed under section 322 of this Act, the proceeding shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter was filed; and the trustee nominated by creditors under this chapter shall be appointed by the court, or, if not so nominated or if the trustee so nominated fails to qualify within five days after notice to him of the entry of such order, a trustee shall be appointed as provided in section 44 of this Act."